Altman Weil, Inc.
The leader in legal consulting.

What Should Law Firms Do About Non-Equity Partnership

By James D. Cotterman

Copyright © 2017 Altman Weil, Inc.
All rights for further publication or reproduction reserved.

The non-equity tier is the fastest growing segment of the private law firm lawyer ranks. It has multiple entry points, few exit points, is often undermanaged, and is growing in an environment where efficiency of service delivery suggests the need for fewer – not more – service partners. Non-equity partners are needed in some situations, but almost certainly not in the numbers seen in most firms.

It is important to note that many non-equity partners can provide clients with significant experience, deep expertise, the ability to independently lead teams and manage portfolios dealing with sophisticated legal issues – and do all this at a billing rate a bit below that of equity partners. The use of a second tier can allow law firms to leverage their equity partners, freeing additional time to build practices and engage in a larger community. Restricting access to equity seats at the table also converts into easier governance and an increase in reported equity partner earnings. Finally, the non-equity tier provides a 'partner' mantle without capital obligations to individuals who lack sufficient business development skills – extending the number of senior, experienced advisors and providing an additional retention tool.

Although there is clearly a case to made for a second tier, law firms need to manage this group with much more attention and discipline – including standards for entry into, retention, and exit from the tier.

Non-equity partners on average work fewer hours than either associates or equity partners. Their lower hours combined with higher base pay can create a drag on firm profitability. Non-equity partner performance should be analyzed in this light and compensation should reflect that analysis. In many cases a slowdown in pay increases and more variable pay based on performance may be warranted. Let us not forget, that non-equity partners are supposed to be profitable – contributing profits to equity partners, not being subsidized by them. All too often the profit margins of the group are in the single digits, sometimes even falling into negative numbers.

There is usually a mixed bag of lawyer categories within the non-equity tier. These include associates moving up, laterals moving in and retiring partners moving down from equity. In each of those sub-groups will be those who will transition through the tier in a few years, and those who become permanent members going nowhere. Law firms should work to clarify the varying non-equity categories, and define appropriate standards, expectations, and assessment factors for each.

Instead of a traditional rating system, law firms should think about using a ranking system for non-equity partners instead. Consider multiple factors in ranking including skills, experience, productivity and behavior. No matter how talented all of your lawyers are, there will always be a continuum from top ranked to bottom ranked. Some simply will be better than others. The lowest in the ranking within each non-equity category are the most likely candidates for action if you want to manage the size of the group and elevate performance.

Each year, the firm should identify the bottom 10% within each category of the non-equity tier and 'solve' those problems – most likely by developing an exit strategy for each. A few may be candidates for some alternative development effort or role, but given the likely need to reduce staffing as efficiency improves and business models adapt to technological enabled capabilities, this should be a very limited outcome, if offered at all.

Over time, the goal is to alter the growth arc of this category and actually reduce the number of non-owner partners the firm has. Do not use the non-equity tier as a 'warehouse' for lawyers who are good but not exceptional. Consciously understaff and fill any gaps with contract lawyers on an as-needed basis.

If you don't have a non-equity tier, proceed with caution. Adding a second tier represents a big change culturally for the firm and financially for the equity partners as it concentrates capital among a smaller group. It is an option, but one that deserves very careful examination.

Non-Equity Partner Checklist

1. Maintain a non-equity tier if you have one, but manage it with much more attention and discipline.
2. Set standards for entry into and exit from the tier and stick to them.
3. Slow pay increases to non-equity partners and make more pay variable based on performance.
4. More clearly define the different types of non-owner tracks and sub-categories within each track.
5. Be clear on appropriate standards, expectations and assessment factors for each.
6. Identify lowest performers each year and resolve performance issues.
7. Over time, reduce the number of non-owner partners the firm has.
8. Consciously understaff and fill any gaps with contract lawyers to improve margins.

James D. Cotterman is a principal with Altman Weil, Inc. He advises law firms on compensation, capital structure and other economic issues, governance, management and law firm merger assessments. Contact him at jdcotterman@altmanweil.com.